Bankruptcy filings, mortgage defaults and foreclosures are closely related

- BAPCPA caused bankruptcies to fall and defaults to rise:
  - 3% for prime mortgages and
  - 14% for subprime mortgages.
- In general, more bankruptcies mean more mortgage defaults. Also more bankruptcies mean more foreclosures.
Foreclosures have very high costs:

• Ex-homeowners must relocate, neighborhood ties lost, kids must switch schools.
• Renters must also move.
• Some become homeless.
• Vacancies cause blight.
• Cities cut public services because taxes fall.
• Foreclosures cause more foreclosures.
Lenders lose 1/3 to ½ of their investment.
But because lenders don’t bear all the costs, they foreclose too often.
Government Programs to Reduce Foreclosures

• By encouraging lenders to modify mortgages instead of foreclosing.

• Obama Admin “Help for Homeowners” program:
  - 500,000 mortgages have started the modification process.
  - Only a few thousand have permanent modifications.

• But lenders have to agree to mods.
Why so few modifications?

- “Pooling and servicing agreements” discourage loan modifications/encourage foreclosures.
- Lenders lose if they modify mortgages:
  - 30% of mortgage defaults “self-cure” and
  - 30% - 45% re-default within 6 months,
So lenders prefer foreclosure and resist modifications. Admin programs are unsuccessful because lenders can veto.
Does bankruptcy help homeowners?

- Chapter 13 helps homeowners save their homes, but it’s not very effective.
- Only 1% of homeowners in Ch 13 save their homes when they otherwise would have lost them.
- Ch 13 is even less effective now, since lower home values mean fewer homeowners want to save their homes.
What about introducing cram-down of mortgages in Chapter 13?

- This would prevent lenders from vetoing modifications, so more would occur.
- Average reduction in mortgage payments if underwater mortgages are cut to current market value is $150,000 over the life of the mortgage.
- This would cause many homeowners to file Chapter 13’s, even if they can afford to repay.
• Too few modifications occur now under government programs, because lenders must agree.

• But too many modifications would occur if cram-down in bankruptcy were introduced, because lenders can’t veto.

• Which is better—we don’t know!